Testimony before the

Committee on Small Business
U.S. House of Representatives

The Honorable Nydia Velazquez, Chairwoman
The Honorable Steve Chabot, Ranking Member

Submitted by
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Chairwoman Velazquez, Rep. Chabot and members of the House Small Business Committee, thank you for holding this hearing on "The Internet Tax Moratorium: The Potential Negative Impacts on Small Businesses of Allowing Moratorium to Expire."

My name is Raymond J. Keating, and I serve as chief economist for the Small Business & Entrepreneurship Council (SBE Council), which is a nationwide, nonpartisan, nonprofit small business advocacy organization. We work on a wide range of public policy issues that are important to entrepreneurs and small businesses.

That most certainly includes the current moratorium on Internet access, and multiple and discriminatory e-commerce taxes that has been in effect since Congress took action in 1998. As you know, this tax prohibition was extended in 2001 and again in 2004, and is scheduled to expire in November of this year. We strongly urge that this moratorium be made permanent.

Today, I would like to touch on four points regarding this issue.

The Economy

First is the economy. We are at one of those points where our economy could easily veer off in almost any direction.

On the negative side are energy costs, housing and sub-prime lending problems, consumers being less confident, and some recent disappointing reports on retail sales and manufacturing production.

Among the positives are rising household net worth, increasing investment in nonresidential structures, solid exports, and good growth in real disposable income in recent months.

Then there are the mixed signals. For example, in the second quarter of 2007, real GDP growth was pretty good, but growth generally underperformed from late 2005 to early 2007. Similarly, real gross private domestic investment was up in the second quarter, but that was after declining during the three previous quarters. Finally, employment growth took a turn down in the latest month, but is up over the past year – in fact, up solidly over the past several years.

In this mix, there are real concerns over tax policy. For example, pro-growth aspects of the 2001 and 2003 tax relief measures are scheduled to expire over the next few years. Will these be extended or made permanent, or will all or part of these measures be allowed to expire, thereby inflicting a large tax increase on the economy?

Similarly, the possibility of states and localities inflicting tax increases on Internet access and e-commerce would loom as another potential problem if the current moratorium expires. Leaps ahead in computer, broadband and other telecommunications technologies have proven to be a tremendous boost for the economy. Taxing Internet access, and/or imposing discriminatory e-commerce taxes will only serve to restrain business and the economy.

Broadband Access

Second, higher taxes on Internet access would mean that the growth in broadband access would be restrained.

That would make a current competitive disadvantage for the U.S. even worse. Keep in mind a story from the August 9, 2007, *Wall Street Journal* ("Is High-Speed Internet Growth Slowing?") that showed broadband household penetration rates in the fourth quarter of 2006 among 25 nations. The U.S. came in last. (The following table reproduces this data, with the source being *The Wall Street Journal*, which acquired the information from Point Topic and WebsiteOptimization.com.)

Nation	Household Broadband Penetration (%)
South Korea	89.0
Monaco	82.9
Hong Kong	79.8
Iceland	75.7
Singapore	69.6
Netherlands	69.4
Denmark	69.3
Israel	69.0
Macau	68.8
Switzerland	66.5
Canada	63.0
Taiwan	61.4
Norway	59.7
Finland	59.5
Guernsey	57.4
France	55.5
Japan	55.1
Germany	53.2
Luxembourg	52.3
U.K.	52.3
Sweden	51.8
Belgium	51.7
Estonia	50.4
Australia	50.2
U.S.	50.1

Creating more tax uncertainty and opening the door to higher Internet taxes are not positive policy developments for investing in broadband networks.

Small Business

Third, obviously, is how this issue affects the small business community.

Small businesses will be hurt in various ways, including the taxes they pay for Internet access, reduced customers via the Internet, and their goods and services potentially facing multiple, punitive levels of taxation. Those are all significant negative threats to the bottom lines of small businesses across the nation.

Advancements in computer and telecommunications technologies have opened up tremendous markets and opportunities for entrepreneurs and small businesses. A permanent ban on Internet access and discriminatory e-commerce taxes would further solidify benefits for consumers and small businesses.

In a recent FoxNews.com article on this topic by SBE Council President Karen Kerrigan, a quote from Monica McGuire of the National Association of Manufacturers drove home the point simply and clearly: "New taxes on Internet access amounts to turning the information superhighway into a high-priced toll road."

Tolls on the information superhighway mean that small business commerce faces higher costs, and the possibility of getting stuck in the slow lane.

State and Local Government

Finally, I'd like to touch on state and local government revenue.

Many state and local government officials, and their representatives, do not like the idea of a permanent ban on Internet access taxes. They, unfortunately, view the Internet as a cash cow to be milked, rather than a source of economic opportunity for all.

They often try to argue that government would somehow be denied the necessary revenues to fund vital services. In reality, however, state and local governments have been rolling in the taxpayer dough. Consider that total revenues for state and local governments increased from $1.4 trillion in 1995 to $2.5 trillion in 2005 (latest U.S. Census Bureau data). That was a huge 78 percent jump, while inflation registered 22 percent over the same period. That included an increase in sales and gross receipts taxes from $237 billion to $383 billion, or a jump of 62 percent.

State and local revenues have been accelerating at some three times the rate of inflation. So, the notion that state and local governments need to extract even more money from taxpayers is very difficult to accept.

To the contrary, more revenue in the hands of government means fewer resources left in the private sector for consumption, investment and job creation.

If Congress wants to hamper the Internet, and related economic opportunities and growth, then clearly this Internet tax moratorium should be ended. But if they wish to see the full potential of the Internet realized, then the current tax moratorium should be made permanent.

Thank you, and I look forward to any questions you might have.